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45 STOCKS THAT ARE CHEAP NOW

DEFLATION AHEAD?

WHY JOHN T[illegible] IS BULLISH

JANUARY 25, 1988

THREE DOLLARS SEVENTY-FIVE CENTS

Forbes

NEVER MIND NEW HAMPSHIRE– WHO WILL WIN HOLLYWOOD?

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Forbes

JANUARY 25, 1988
VOLUME 141
NUMBER 2

THE EDITORIAL INDEX OF COMPANIES REFERRED TO IN THIS ISSUE IS ON PAGES 132 AND 133.

COVER STORY

77 Campaign '88: Get Ready For "Selective Reality"
By Allan Dodds Frank
Charlton Heston and Clint Eastwood were ready to respond to Gregory Peck's attacks on Judge Bork. Why didn't the White House use them? Doesn't it know that politics and show business are merging?

COMPANIES

37 Shaw Industries
By Kerry Hannon
Robert Shaw's carpet company is fairly young—but it has double the revenues of its nearest competitor.

38 Hilton Hotels
By John Heins
It may look like a raider's delight. But don't underestimate Barron Hilton.

44 NCNB Corp.
By John Taylor
Hugh McColl has done a terrific job of building this bank. But a soothing spokesman he is not.

46 Hallmark Cards
By Steve Weiner
How is the company coping with a strong challenge from smaller, more creative rivals?

52 Sallie Mae
By Janet Novack
Look, Ma, no risk: A well-hedged, government-guaranteed portfolio.

59 The Up & Comers: I, Berlusconi
By Tatiana Pouschine
Meet Silvio Berlusconi—who figured out that European audiences like the same TV fare as Americans.

INTERNATIONAL

36 Enjoy! Enjoy!
By Andrew Tanzer
Spend more, the U.S. urges Japan. The Japanese are responding, but in ways that do the U.S. little good. They are gorging on gold, diamonds, jewelry.

84 Immigration Law
By Hesh Kestin
Congress' solution to a travesty: A new law that is even worse.

LABOR

48 Money For Nothing
By Richard Greene
To fight malingerers, is the carrot better than the stick? Ask GM, which found out the hard way.

PERSONALITIES

40 T. Boone Pickens
By William P. Barrett
Time was when corporate chieftains blanched at his very name. Today he doesn't even get his way in his little hometown.

INVESTING

34 Retirement Center Bonds
By Matthew Schifrin
Congress gave a tax break to developers of retirement communities. Some break. It has left senior citizens in bankrupt projects, and bond buyers deeply underwater.

DEPARTMENTS

6 Side Lines
8 Follow-Through
12 The Informer
14 Readers Say
17 Fact and Comment
22 Other Comments
25 Fact and Comment II
135 Flashbacks
136 Thoughts

COLUMNISTS

119 Ben Weberman
120 David Dreman
122 Ann C. Brown
124 James Grant
125 Stanley W. Angrist
126 Mark Hulbert

MONEY & INVESTMENTS

29 What's Ahead For Business
30 The Forbes Index
111 The Forbes/Wilshire 5000 Review

Cover illustration by Robert Grossman

34 *Bad bonds*

40 *Pickensville*

81 *Templeton*

55 The Formula And The Crash
By Allan Sloan and Richard L. Stern
What happens when perfectly good academic theory is converted into a magic formula.

81 The Money Men: A Talk With John Templeton
By Thomas Jaffe
Are we in a bear market? Yes, says this venerable investor, but the next bull market is going to beat any that has gone before.

114 The Funds: Spreading The Faith
By Ruth Simon
You can buy a Third World fund either to propagate capitalism or to get rich. Either way you may be disillusioned by the results.

116 Statistical Spotlight: Bargains—If
By Steve Kichen
These stocks are bargains—if they live up to their earnings forecasts or even come fairly close.

130 Streetwalker
Mexico's debt troubles make an interesting case for European bank stocks. Also: The One Bancorp; George Banta Co.; Duff & Phelps Selected Utilities Fund; the British case for U.S. stocks; Ferro Corp.

ON THE DOCKET

86 Lemon Laws
By Deirdre Fanning
Protecting the rights of car buyers seemed like a good idea when consumer legislation started to spread in the mid-Seventies. But when is a bad car a lemon?

MARKETING

87 Case Study: Pyrex
By Toni Mack
Why are so many products badly designed? Sometimes the product designers themselves don't know that there's a problem until they are forced to make a change.

SCIENCE & TECHNOLOGY

90 Compact Databases
By Gary Slutsker
The explosive growth in compact disks as information banks. Also: The factory in your office.

PERSONAL AFFAIRS

96 Golf With A Shotgun
By John Frederick Walker
You don't have to be a bird killer to enjoy shooting: Clay pigeons are getting smarter all the time. Also: Absentee ballots; the upcoming auction of the Warhol collection; and Sotheby's Art Market Trends.

CAREERS

103 A Techno-Innovator
By Kathleen K. Wiegner
Innovation may look simple in retrospect, but the journey can be long and hard. Case in point: Ted Smith's success in document-imaging.

FACES BEHIND THE FIGURES

106 Lawrence Summers, *Harvard economist*
106 Michael Goldblatt, *McDonald's Corp.*
108 Ramnath Goenka, *Indian publisher*
108 Thomas Graham, *USX steelmaker*

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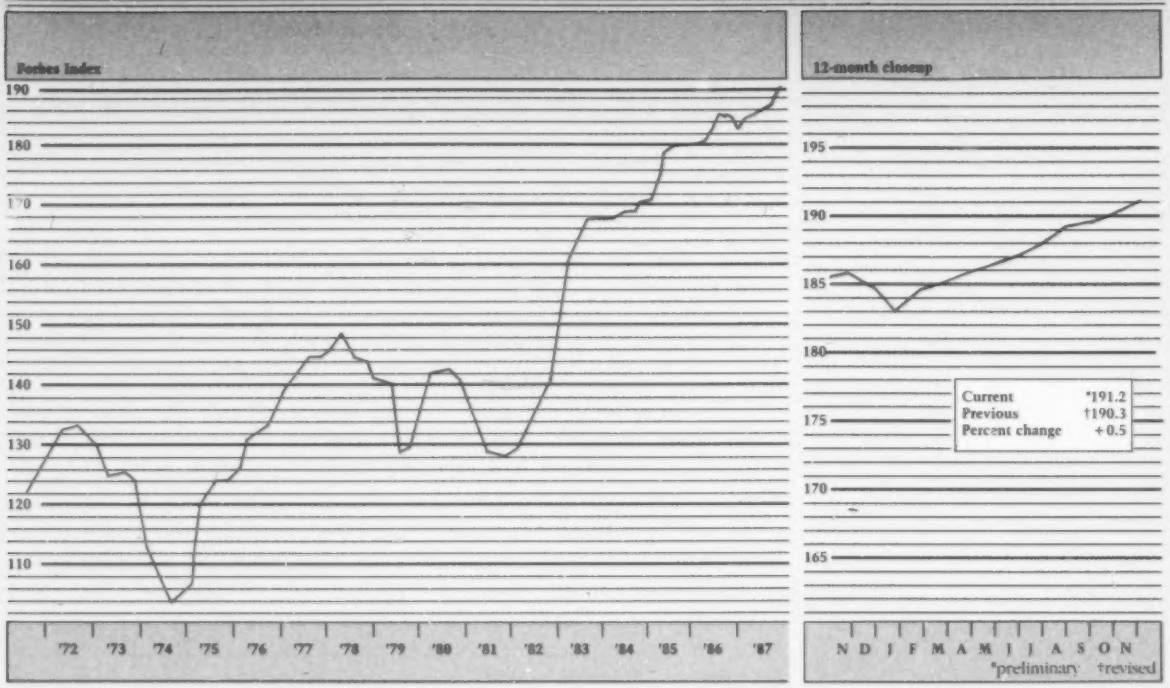
The Forbes Index



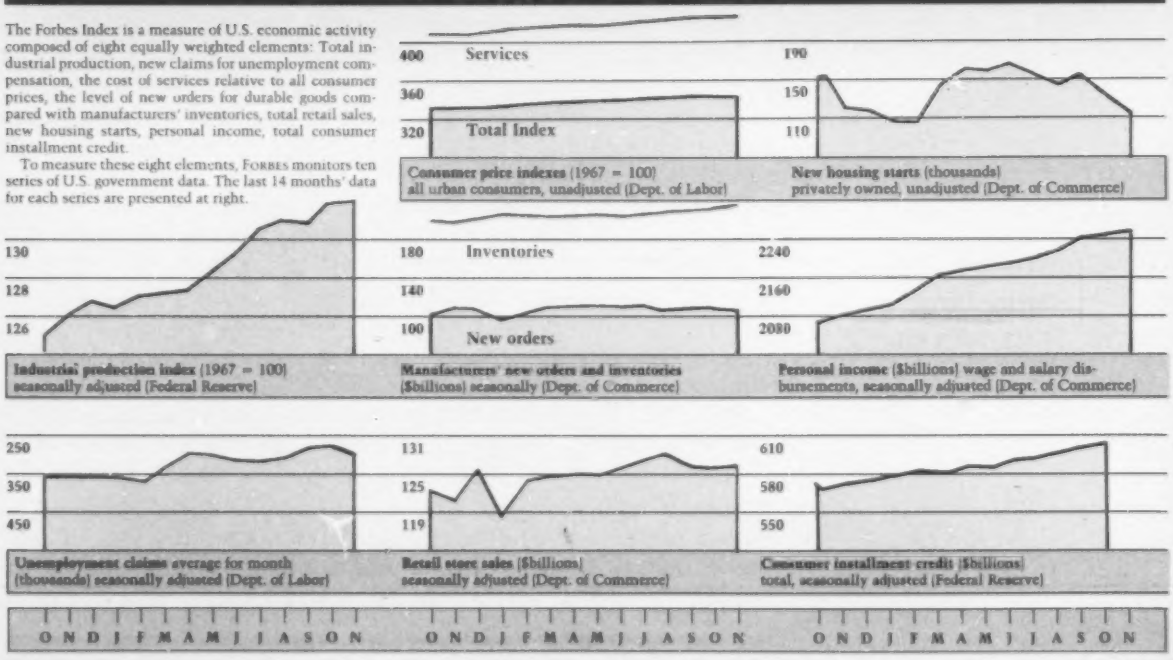
Signs of a slowdown. Despite a preliminary 0.5% rise in the Forbes Index for the month of November, several Index components signal a weakening ahead in the economy. The six-month total of unemployment claims rose 1.6%. Results for November, reflecting layoffs in Detroit and Wall Street, show a 3.9% jump over the October unemployment figure. Manufacturers' new orders fell 0.4% in November, but the 3-month total of new orders to November inventories was up 0.3%. The 12-month total for new housing starts rose 0.1%.

Industrial production increased 0.4% over October. Gains of 0.7% for personal income and 0.2% for retail sales also supported the Forbes Index. Thus, the economic expansion remains alive, but it is not in good shape.

The Forbes Index Components

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.


400
360
320
Services
Total Index
Consumer price indexes (1967 = 100) all urban consumers, unadjusted (Dept. of Labor)
190
150
110
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)
130
128
126
Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)
180
140
100
Inventories
New orders
Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)
2240
2160
2080
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)
250
350
450
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)
131
125
119
Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)
610
580
550
Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)
O N D J F M A M J J A S O N
O N D J F M A M J J A S O N
O N D J F M A M J J A S O N

Forbes

Congress gave a tax break to developers of retirement communities. Some break. It leaves senior citizens in bankrupt retirement homes and has cost bond buyers around a half billion dollars in losses.

An expensive free lunch

By Matthew Schifrin

RETIRED ARMY Colonel Thomas Miller well remembers the day he attended a free-lunch investment seminar at Tucson's OK Corral. After dining on steak and potatoes, the 72-year-old Miller and about two dozen other gray-haired seniors listened to a pitch on tax-free investing in the retirement industry. The seminar's sponsor: Buchanan & Co. of Jackson, Miss.

"They were very smooth," says Miller. "They told us that municipal bonds were 99% safe." Three years and five lunches later, Miller has already lost $66,500 of the $131,000 he invested in bonds secured by nonprofit retirement communities.

Tom Ives/Comstock

Tucson retirees Colonel Thomas and Mary Miller
Their free lunches have cost them $66,500 so far.

And not only bondholders are being cheated. One of Miller's defaulted bonds is for the 240-unit Skylyn Hall retirement center in Spartanburg, S.C. Just a few days before Skylyn's bankers foreclosed, Julia Manning paid $34,000 for a Skylyn unit. At 93, Manning requires a companion to help her get by from day to day. Adding to her worries, Skylyn's promised on-premises nursing home may never open.

Manning and Miller are only two among tens of thousands of victims of a billion-dollar tax-exempt bond scandal. If you haven't heard of this scandal, it's because there's no sure way of tracking the issuers or the victims, since these elderly-housing issues are exempt from SEC registration. Congress accorded them that dubious exemption by allowing them to be treated as "municipal" bonds. This much is now clear: Over $1 billion in defaulted retirement facility and nursing home bonds have already cost unwary investors hundreds of millions of dollars.

No underwriter has been more aggressive in this game than Buchanan & Co. of Jackson. Over the last five years this obscure brokerage has underwritten some $600 million worth of tax-exempt retirement center and nursing home bonds. Of the estimated $5 billion worth of such bonds marketed nationwide in the last ten years, over $1 billion worth, raised in 100 issues, has gone into default. About half of the 100 defaulted issues were marketed by Buchanan & Co.

Congress has closed the door on most other tax-free revenue bonds (or subjected them to state-by-state ceilings). With brokers thus gasping for product to peddle, tax-exempt financing for retirement facilities has been attracting such big-time underwriters as Smith Barney and Morgan Stanley. But they have been relatively small players. Buchanan has been one of the biggest players, flooding the market with tax-exempt paper with little regard to the quality of the projects secured by the bonds. During the late 1970s and early 1980s Buchanan did a successful business in underwriting tax-exempt bonds for utility districts and nursing homes. Why not transfer this success to the financing offered to retirement home projects? Buchanan plowed ahead.

For Buchanan, which already had offices set up in Tampa, Tucson and

other Sunbelt cities, marketing the bonds proved a snap. For target investors, the firm aimed at senior citizens, who, after all, would naturally be sympathetic to the purpose of the projects. (As a rule, however, investors were not also residents.) At the lunch seminars, bondholders claim, salesmen would routinely suggest that retirement centers were just like nursing homes and that municipal bonds were as good as money in the bank. Buchanan advertised juicy tax-free rates—12% to 16%—on first mortgage bonds. To attract developers and projects to finance, Buchanan advertised 100% financing in health industry trade magazines.

The brains of the operation was—and is—Robert Buchanan Jr., 51, a penny-pinching onetime pharmacist and son of a Mississippi preacher. Known as a taskmaster who, former employees say, goes out of his way to check the return slots of pay telephones for uncollected coins, Buchanan personally does much of the digging that turns up promotable projects. He declined to be interviewed for this story, clearly preferring to keep a low profile.

What buyers of the bonds did not always realize, however, is that—as with other private-purpose revenue bonds—the nominal issuer, a municipality, is not in fact the borrower. These are not full faith and credit

E.A. Kennedy III/The Clarion Ledger

Buchanan & Co.'s Robert Buchanan Jr. ***Keeping a low profile in Jackson.***

bonds. The municipality simply lends its tax-exempt status to a special, nonprofit entity created to own and run the project once it is built. So even though bond prospectuses brandish names like New Jersey Economic Development Authority and the Mesa, Ariz. Industrial Development Authority, the entity backing the bonds is actually the poorly capitalized nonprofit entity.

No surprise that the $5.5 million retirement village in Bowling Green, Ky., a Buchanan bond issue that came out in 1983, is trading at about 10 cents on the dollar after defaulting in 1984. Hunt's Healthcare, an Indiana nursing home Buchanan underwrote in 1985, is going for 75 cents, even though it is still paying interest—out of its reserve fund, however.

"These are the penny stocks of the bond business," says Richard Lehmann, whose Miami-based Bond Investors Association tracks defaults of both muni and taxable bonds. Most of the retirement home issues are unrated by Moody's or S&P, and like all municipals they are not registered with any state or federal regulatory agency.

Thus unrated and unregistered, the bonds could not be easily sold to well-informed investors. Which is why Buchanan went out and beat the bushes for relatively unsophisticated investors tempted by high yields.

One reason so many of Buchanan's projects flop is that the sites are hastily chosen and are often totally inappropriate locations for retirement homes. Take the Edwinola retirement center, a 255-unit, Buchanan-financed project located smack in the center of run-down Dade City, Fla., 30 miles north of Tampa. Four months after opening in late 1983 the project filed for bankruptcy, having attracted fewer than 15 residents.

The ten worst

Apart from the $2.25 billion WPPSS bankruptcy, the $1 billion in defaulted retirement facility bonds stands as the worst muni bond disaster in history. Below, the ten biggest underwriters of these issues.

Underwriter	Defaults ($mil)	Number of projects	Comment
Buchanan & Co. Jackson, MS	$390†	51	Free lunch seminars corralled some $600 million of bond buyers. Most feasibility studies from May Zima & Co.
Hereth, Orr & Jones* Atlanta, GA	270†	10	After several defaults of bonds it underwrote, was shut down late 1983 for net capital violations. Feasibility firms include Laventhol & Horwath, Price Waterhouse.
Swink & Co. Little Rock, AR	106†‡	7	After retirement projects in 4 states defaulted, still very active in junk munis. Feasibility firms include Laventhol, May Zima.
Henderson Few & Co. Atlanta, GA	106†	6	Founder Gerry Henderson moved from Atlanta to Sarasota, Fla. Now active in retirement center workouts.
Miller & Schroeder Minneapolis, MN	97†	4	Placed many of its bonds in insured unit trusts. Feasibility firm: Laventhol.
J. Milton Newton & Co.* St. Petersburg, FL	58	4	Founder J. Milton Newton taught Robert Buchanan Jr. the business. After financial reversals in 1984, Newton committed suicide in office.
Juran & Moody St. Paul, MN	36	2	Successful in utility district bonds, encountered problems in retirement centers.
Blyth Eastman PaineWebber New York, NY	33†	1	Defaulted retirement home bonds settled in 1985 for 91 cents on the dollar.
Herbert J. Simms New York, NY	33†	1	Only default of the dozens of retirement centers it has underwritten. Default settled in 1985 (see Blyth Eastman).
Merrill Lynch New York, NY	32†	1	Failed Westminster Village in Daphne, Ala. refinanced twice, now 68% occupied. Merrill Lynch made good the losses of original bondholders.

*No longer in business. †Full amount credited to co-underwriters. ‡Includes participation in selling syndicate of $53 million Royal Regency project.

Sources: Bond Investors Association, bank trustees, dealers, Forbes.

In short, some projects were built more as an excuse for issuing bonds than on the basis of sound studies.

In some cases, construction costs were allowed to escalate out of control. In one such project, the Pataskala Country Manor in Licking County, Ohio, Buchanan raised $2.3 million through a 1985 tax-exempt bond issue. But all the money was gone before construction was completed.

In virtually all the cases, Buchanan and its partners routinely skimmed off so much money in upfront underwriting and related fees that there was little left to execute the project itself.

Take Buchanan's Sun Mesa Health Care Project outside Phoenix, Ariz. Less than $9 million of the original $15.5 million bond issue in 1984 was allotted for land and construction. Most of the rest was committed to fees, including more than $1.6 million, or 10%, to Buchanan itself. According to the prospectus, around $500,000 in fees was for marketing the units. But marketing was legally impossible—since the promotors never got the necessary state permit.

The now-defunct Atlanta office of May Zima & Co., a firm listed on dozens of failed retirement projects, came up with Sun Mesa's rosy feasibility study. According to May Zima's assumptions, Sun Mesa, which never opened, would be up to 90% occupied within three years of the bond issue. At the time, there were 3,254 units in other retirement homes already operating in the area and another 725 units under construction. All this was routinely mentioned in the prospectus, but most of Buchanan's bond buyers weren't the kind who read prospectuses.

Not satisfied with fat fees, Buchanan & Co. has found a way to profit from its failures by speculating in the defaulted issues. When projects fail, Buchanan's brokers, as market-makers, can buy back the bankrupt bonds at 20 cents to 40 cents on the dollar. At the same time Buchanan sometimes brings in a workout team to help revive the project.

Buchanan has had company in retirement underwriting. Merrill Lynch underwrote a $32 million, 292-unit Alabama retirement center that went bust nearly three years after the bonds were issued. To its credit, Merrill Lynch made good the losses. But less than 10% of the defaulted projects have been underwritten by major firms. The primary peddlers of these unrated high-yielding tax-exempts are regionally based muni dealers—like Buchanan—clearly unable and unwilling to make investors whole.

Buchanan & Co. is facing at least six lawsuits in four states. A court victory for investors could be hollow, however. Last year the firm lost $2.5 million, according to the Mississippi securities commissioner, and as of October 1987 was down to $418,000 in capital. It's a lesson that investors keep learning over again the hard way: Bonds that pay way above market interest rates may be no bargain. And just because something has a tax benefit doesn't mean that it's a good investment. ■

Spend more, the U.S. urges Japan. The Japanese are responding, but in ways that do the U.S. little good. They are gorging on gold, diamonds, jewelry.

Enjoy! Enjoy!

By Andrew Tanzer

TADAHIKO FUKAMI recalls with relish when the Tokyo stock market tested new heights last August. Waves of wealthy customers swarmed to his Yamazaki Co. stores, where many of them plopped down million-yen bundles of notes wrapped in the paper of Japanese securities companies.

Having sold stocks, what were they buying? Gold, platinum, diamonds and other precious metals and jewelry pieces. Annual sales at Fukami's Yamazaki have doubled (in yen terms) in five years, to $230 million. "People have become rich here," explains Fukami. "But they can't afford to buy land or houses, so they're buying jewelry instead."

Japan is entering a golden age. After sweating and sacrificing to rebuild their economy and supply themselves with modern life's basics, middle-class Japanese are now beginning to indulge themselves in life's luxuries, from mink coats and BMWs to precious metals and jewelry.

To catch some of the spending, trading companies such as Sumitomo Corp., Japan's biggest gold dealer, are

David Wade

Sumitomo Corp.'s Akio Imamura
"The government was too confident."

several paintings by the masters of 19th-century academic art, including work by Bouguereau, Alma-Tadema and Gérome.

Not surprisingly, Warhol owned scores of important paintings by such leading contemporary artists as Jasper Johns, Roy Lichtenstein and Robert Rauschenberg, and the work of such younger artists as Keith Haring and Jean-Michel Basquiat. Sotheby's will also be auctioning Warhol's extensive collection of 1940s jewelry by Cartier and Van Cleef & Arpels, 1940s and 1950s wristwatches by Cartier and Rolex, American Indian art and Japanese baskets.—**Ronald Bailey**

The living room of the late Andy Warhol's East Side town house

Sotheby's Art Market Trends

Index sectors	Dec 1987	One month ago	One year ago	Two years ago	Five years ago	One month % change	One year % change	Two year % change	Five years % change	Five years average annual % change
Old Master paintings	373	349	303	289	205	+6.9	+23.1	+29.1	+82.0	+12.7
19th-century European paintings	323	323	279	249	184	nil	+15.8	+29.7	+75.5	+11.9
Impressionist & Post-impressionist art	723	661	490	380	267	+9.4	+47.6	+90.3	+170.8	+22.0
Modern paintings (1900-1950)	757	666	512	364	245	+13.7	+47.9	+108.07	+209.0	+25.3
Contemporary art (1945 onward)	609	609	551	497	342	nil	+10.5	+22.5	+78.1	+12.2
American paintings (1800-pre-WWII)	871	789	698	667	450	+10.4	+24.8	+30.6	+93.6	+14.1
Continental ceramics	331	320	290	284	266	+3.4	+14.1	+16.5	+24.4	+ 4.5
Chinese ceramics	581	550	526	486	436	+5.6	+10.5	+19.5	+33.3	+ 5.9
English silver	381	381	343	306	189	nil	+11.1	+24.5	+101.6	+15.1
Continental silver	220	220	201	181	139	nil	+ 9.5	+21.5	+58.3	+ 9.6
American furniture	459	459	404	330	213	nil	+13.6	+39.1	+115.5	+16.6
French & Continental furniture	319	319	299	273	234	nil	+ 6.7	+16.8	+36.3	+ 6.4
English furniture	634	634	517	419	267	nil	+22.6	+51.3	+137.5	+18.9
Aggregate index*	512	482	403	344	252	+6.2	+27.0	+48.8	+103.2	+15.2

Basis: 1975 = 100 ($).

©Sotheby's 1988

*Contemporary art was added to the Art Index in September 1987. The aggregate index excludes this category prior to that date.

Sotheby's Art Market Trends reflect subjective analyses and opinions of Sotheby's art experts, based on auction sales and other information deemed relevant. Nothing in Sotheby's Art Market Trends is intended as investment advice or as a prediction or guarantee of future performance or otherwise.

Index highlights

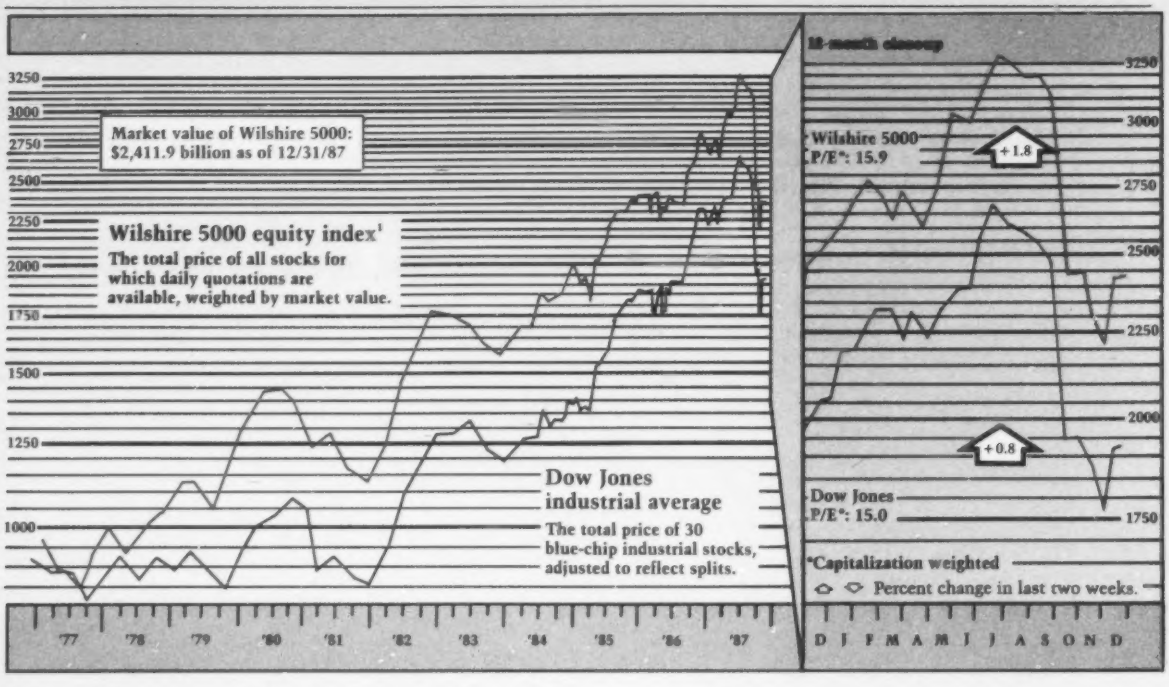
The New York sales of American paintings, which appeal almost exclusively to American collectors, were strong overall due to the excellent quality of art on offer. Many works rarely seen on the auction market were included, such as top-level paintings by Edward Hopper, Martin Johnson Heade and Georgia O'Keeffe, as well as sculpture by Elie Nadelman.

The hallmark of many of the sales in London was the presence of a two-tier market: demand was very strong for works of blue-chip quality but not as competitive for art of less than premier rank. At the major round of Impressionist and Modern paintings sales, for example, a record price of $13.6 million was set for the Degas painting "Les Blanchisseuses" and an important early work by Picasso, "Souvenir du Havre," established a new auction record for the artist—$7.6 million—while less important works by the same artist either sold within estimate or remained unsold. The strong upward movement in the Indices in these sectors owes something to the present weakness of the dollar, but there is considerable real growth in the underlying price structure in these fields.

Sales of Old Master paintings in London showed much the same pattern, with considerable competitive bidding on attractive, problem-free paintings that had not been on the market recently. Other works which had had wide market exposure in the recent past or which were considered unattractive proved more of a problem.

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



January in December. Wall Street lore has it that small stocks get pushed down by tax-loss selling in December but then surge in the first month of the new year. This time the so-called January effect came a little early. In the last two trading weeks of December, Amex and Nasdaq issues rose 3.7% and 3.4%, respectively. The overall market, as measured by the Wilshire index, gained only 1.8%.

Have small stocks already used up their potential January gains? Perhaps not. Even with their last-minute surge, secondary stocks finished the year behind primary issues. In 1987 Nasdaq stocks declined 5.3%, while Amex shares were off 1.1%. The Wilshire index lost only 0.7%, while the Dow 30 shows a 2.3% gain. At year-end 1986 the Dow's P/E against trailing earnings was 13.8, vs. 17.8 for the Wilshire index. At the end of last year the Dow P/E was 15, compared with 15.9 for the Wilshire index.

Closeup On the Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	9.3	8.8	9.1	8.8	10.1	10.6
in last 52 weeks	–0.7	0.1	2.3	–0.3	–1.1	–5.3

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	10.6	5.6	7.4	3.5	13.5	5.3	1.5	11.2	10.3	6.3	9.8	5.7
in last 52 weeks	2.1	10.6	17.0	6.3	–2.1	–6.9	–6.1	25.9	21.5	0.4	2.1	7.4

[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

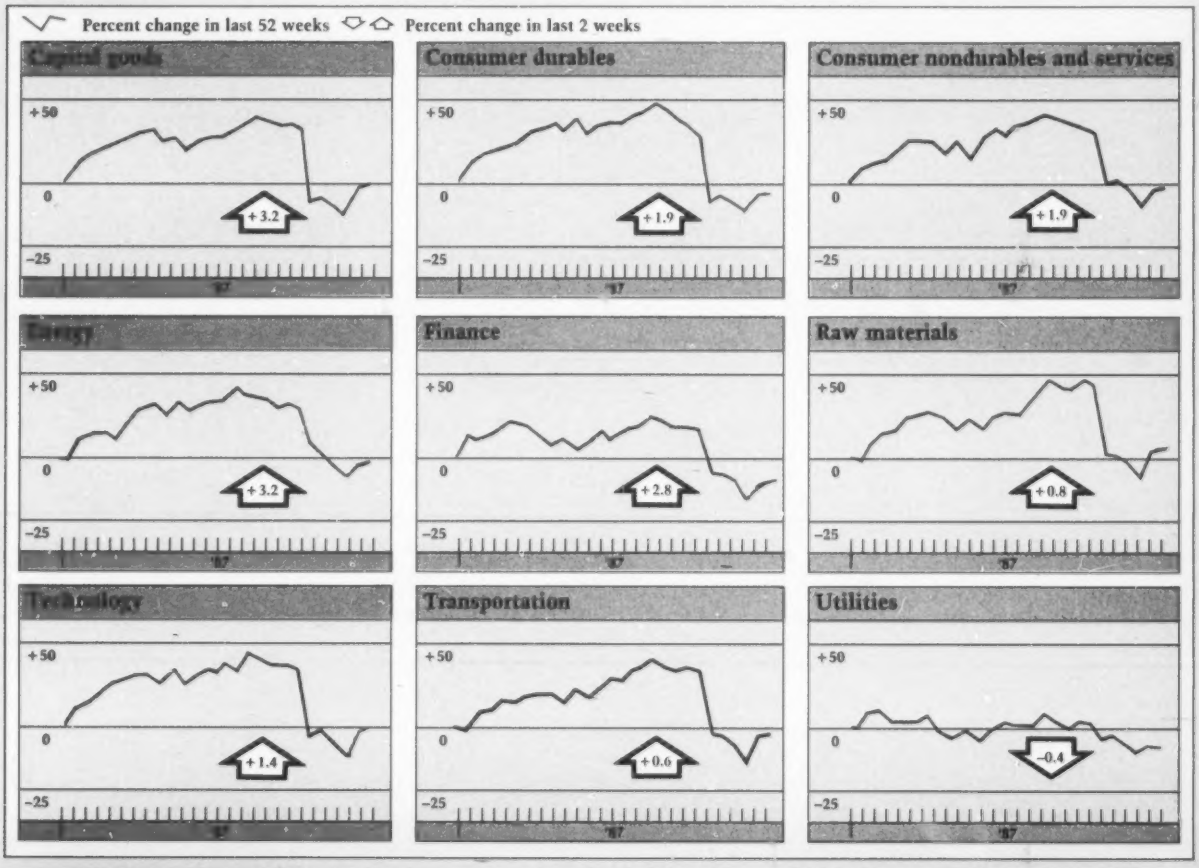
Note: All data for periods ending 12/31/87. Prepared by Wilshire Associates, Santa Monica, Calif.

Shelley Dell

Where the Action Is

Good-bye cheap oil? The early December oil price decline may not last: Quotes stabilized by year-end. In the last two weeks the energy group rose 3.2% and scored a first-place tie with capital goods. The best energy stock was Phillips Petroleum, which rose nearly 35% in two weeks. Laurence Tween, an oil analyst with Kidder, Peabody, notes, "Phillips rose on speculation that it might become a target for Pennzoil. With $3 billion in cash from Texaco, Pennzoil is reportedly looking to acquire additional reserves." Tween thinks that Phillips, recently trading at 14, has a breakup value of about $21 a share.

Energy was one of six sectors that beat the Wilshire index last year. A 15.8% drop in finance stocks and 8.6% drop in utility issues pulled down the overall market.



What the Analysts Think

Finance looks cheap—at first glance. Finance stocks are priced at only 6.7 times estimated 1988 earnings, while the Forbes Sales 500 has an estimated multiple of 10.1. But security analysts have been slashing their 1988 forecasts for the finance group. If this keeps up, the group may not be such a bargain.

Forecasting the Forbes Sales 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.41	15.0
1988 estimates	3.60	10.1
1989 estimates	NA	NA

NA: Not available

Rank based on change in estimate	Sector	Estimated 1987 EPS	Estimated 1987 P/E	% change in 1987 estimate in 2 weeks	% change in 1987 estimate in 4 weeks
1	Raw materials	$2.85	11.3	0.31%	0.75%
2	Utilities	3.06	9.1	-0.03	-0.29
3	Technology	2.94	11.1	-0.10	-0.57
4	Consumer nondurables	2.59	11.9	-0.26	-0.65
5	Energy	3.00	11.8	-0.28	-0.85
6	Capital goods	2.50	14.1	-0.90	-1.89
7	Transportation	2.53	11.4	-1.19	-3.47
8	Finance	3.69	6.7	-1.68	-2.95
9	Consumer durables	4.06	11.8	-1.87	-3.36

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continually by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 12/31/87. Prepared by Wilshire Associates, Santa Monica, Calif., IBES, a service of Lynch, Jones & Ryan, New York.